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Alternative Sources of Debt Finance

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Asia Mezzanine Capital Group

Mobilizing global capital for Asia's most promising companies



- I. Current Market Situation**
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 - *Key Pricing Considerations*



Current Market Situation

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- The Asian buyout market activity is relatively slow although markets are open.
- Firms continue actively to pursue, announce and/or close transactions in China, SE Asia, Japan, Korea and Taiwan.
 - In Japan, KKR announced its first Japan buyout of a recruitment services business.
 - In Indonesia, CVC AP closed the first buyout in that market.
 - In China, local and global PE firms pursuing several control transactions, usually with little leverage (or alternatively using offshore structures).
 - One current trend in the Chinese market is for PE firms to close transactions with 100% equity, looking either for back leverage or depending on high growth rates and multiple expansion to meet return hurdles.
- Financing markets remain open for business in most markets in Asia, although pricing remains a bit wider in the senior debt markets.
 - Local Asian banks and other financial institutions remain very active, often offering tighter pricing and better terms than international banks. This trend is most notable in Japan, Taiwan and Korea.
 - A refinancing in the market for Oriental Brewery in Korea, is being led by a local bank (KDB) and has all in pricing of approximately 300 bps compared to a margin only of 600 bps when the deal was done in 2009.

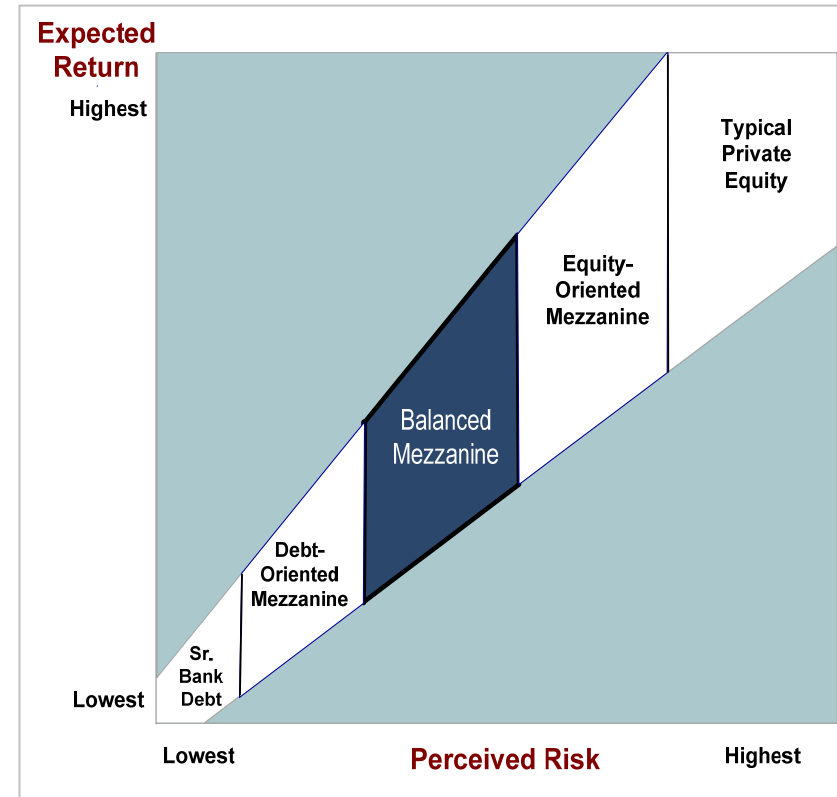
Types of Mezzanine: *Expected Return/Perceived Risk Profiles*



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Common Characteristics:

- Layer of capital between senior debt and common equity
- Repayment of debt component through amortization or bullet payment
- Covenant protection and some degree of creditor rights usually subordinated
- Maybe equity participation in some form



Characteristics of Mezzanine by Type: *Debt-Oriented vs. "Balanced" vs. Equity-Oriented*



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	Debt-Oriented Mezzanine "Lending"	Balanced Mezzanine "Investing via Credit Methods"	Equity-Oriented Mezzanine "Investing via PE Methods"
Perceived Risk Level	Lowest	Intermediate	Highest
Expected Returns	Lowest returns, with highest return from debt component	Higher overall returns with potentially attractive capital appreciation from equity component comprising 40% to 60% of overall IRR	Highest returns, with equity component comprising 75-100% of the overall IRR
Instruments Used	Typically, shorter-term standardized senior and junior debt securities	Generally, more complex longer-term hybrid debt and equity securities with a tailored combination of components.	Typically, convertible preferred equity or debt instrument at holding company level with few rights
Issuers	Medium-sized and larger more well-established companies and sponsors seeking lowest possible cost of debt capital	Medium-sized companies, which are generally less established but with proven managements and performances, and which are seeking mezzanine as a catalyst for growth by expansion and acquisition, by MBOs, MBIs, restructurings/recaps	Principally start-up and early stage companies
Source of Opportunity	Relationships with private equity sponsors, financial advisers and commercial banks	Direct, often proprietary, as well as from relationships with PE sponsors; and with financial advisers and with commercial banks	Direct or via brokers
Nature of Evaluation and Due Diligence	Focused on principal preservation, risk avoidance and the value of security shared with other creditors; prospects for refinancing via an IPO or trade sale	Focused principally on prospects for principal preservation, cash flow generation capability, risk-mitigation, downside protections combined with evaluation of equity upside potential	Focused on equity upside potential
Structuring	Typically pre-structured by private equity sponsor, financial advisers, banks	Complex, requiring creative capital structure solutions by mezzanine investor	Often standardized convertible preferred equity or debt instrument requiring less documentation
Monitoring / Alignment	Alignment mainly with other creditors and sole focus on loss avoidance can negatively impact relationship with owners	Both creditor and equity interests which promotes alignment of interest and effective "partnership" with owners	Closest alignment of interest with owners
Exit Routes	Typically, from prepayment from refinancing via IPO or trade sale	Generally, combination of amortization / redemption, and trade sale or IPO	Generally, solely from trade sale or IPO.

Characteristics of Mezzanine: *Regional*



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	US	Europe	Japan/Korea	China	India	Other Asia
Key Types / Uses	Middle Market Buyouts (but some small enterprise growth capital)	Large Buyouts Middle Market Buyouts Rarely growth capital	Buyouts	Growth Capital Some Buyouts	Growth Capital Some Buyouts	Growth Capital Some Buyouts
Type of Debt Subordination	Contractual (almost always)	Contractual and/or Structural	Usually contractual subordination	Usually structural subordination	Structural and contractual	Usually structural; Some contractual
Equity Kicker	Sometimes	Sometimes	Sometimes	Almost always	Almost always	Almost always
Debt or Equity-oriented	Debt-oriented	Debt-oriented	Debt-oriented	Balanced Hybrid	Balanced Hybrid	Balanced Hybrid
Expected returns	14-17% (USD)	11-15% (EUR)	9-14% (JPY)	16-26% (USD)	14-24% (USD)	18-26% (USD)
Opportunities 2010-2012	Moderate	Low	Low	High	Moderate	Moderate



1 – Fill a Financing Gap

Cases where Investee otherwise have limited access to more senior debt:

- Can serve as the only “debt-type” capital
- May leverage other debt and equity capital

2 – Minimize Equity Dilution

Lower the cost of capital relative to ordinary private equity:

- Trades off potentially unlimited, but uncertain, equity returns for a lower but somewhat more certain return debt-like return, while preserving elements of equity participation, with flexible terms.
- Less equity dilution for existing shareholders

3 – Leverage to Boost Equity Returns

Enhance equity returns in buyouts as complement to already “maxed-out” prudent levels of senior debt .

Reduce amount of cash equity required by sponsor.

4 – Offer Flexibility

Structure transactions to meet needs of clients:

- Adjust amortization schedule to match cash flows
- Some element of PIK is workable
- Can utilize mechanisms to reduce dilution

5 – Provide Other Strategic & Financial Benefits

Support, Advice and Assistance

- Non-competing capital
- Longer-time horizon than banks and hedge funds
- Validation of the business and its strategy
- Financial strategy, corporate governance, others
- Provide region/global relationship-access via network

Applicable to:

Growth Capital

Buyouts

Mezzanine Value Propositions for Investees & PE Sponsors:

Growth Companies



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Minimize dilution while achieving a growth company's fund raising objectives:

Founding Shareholding		Financing Round A		Financing Round B		IPO Round	
Shares	%	Shares	%	Shares	%	Shares	%

Case A - Mezzanine Capital Not Utilized

Founders	1,000,000	100.0%	1,000,000	76.9%	1,000,000	58.8%	1,000,000	43.5%
New Investors A - Equity			300,000	23.1%	300,000	17.6%	300,000	13.0%
New Investors B - Equity					400,000	23.5%	400,000	17.4%
IPO Round							600,000	26.1%
Total	1,000,000	100.0%	1,300,000	100.0%	1,700,000	100.0%	2,300,000	100.0%

Case B - Mezzanine Capital Utilized

Founders	1,000,000	100.0%	1,000,000	76.9%	1,000,000	69.9%	1,000,000	52.7%
New Investors A - Equity			300,000	23.1%	300,000	21.0%	300,000	15.8%
New Investors B - Mezzanine					130,000	9.1%	130,000	6.9%
IPO Round							467,641	24.6%
Total	1,000,000	100.0%	1,300,000	100.0%	1,430,000	100.0%	1,897,641	100.0%

Preserve higher level of founders' ownership

Facilitate strategic growth and path to IPO

Substitute mezzanine capital for an otherwise too high share of equity

Implications for Founders' Equity

Dilution Avoided via use of Mezzanine Capital

14.4%

Relatively Larger Percentage Held by Founders via Use of Mezzanine Capital

21.2%

Mezzanine Value Propositions for Investees & PE Sponsors: *Sponsored Buyouts*



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- Source of significant amounts of non-competing quasi-equity capital
- Enhance equity IRR via additional leverage at a lower cost of capital than ordinary equity:

	Case 1 Senior & Equity	Case 2 Senior/Mezzanine/Equity
Financing	<i>Amount</i>	<i>Amount</i>
Senior Debt	231.3	219.9
Mezzanine	-	57.7
Equity	129.2	82.9
Total	360.5	360.5
Structure	<i>Percent</i>	<i>Percent</i>
Senior Debt	64%	61%
Mezzanine	0%	16%
Equity	36%	23%
Total	100%	100%
Multiple of EBITDA		
Senior Debt/EBITDA	3.6	3.4
Mezzanine/EBITDA	0.0	1.2
Equity/EBITDA	2.6	1.7
Total / EBITDA	6.2	6.2
IRR		
Senior – swapped	8.0%	7.5%
Mezzanine	N/A	19.8%
Equity	27.8%	31.1%

Reduce cash equity required

Enhance equity returns

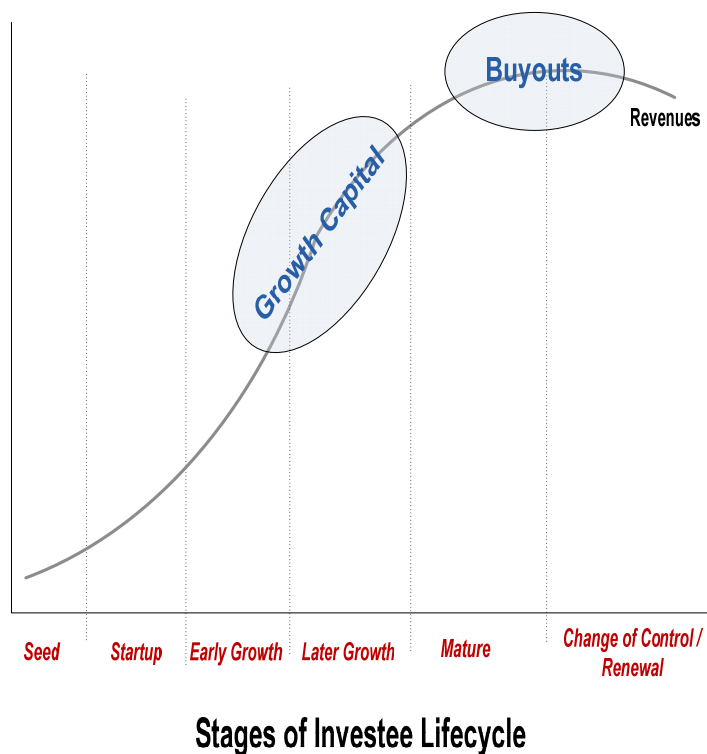
Alternatively, enable a higher bid price at a preserved IRR
27.8% = 383.2

Improve terms of senior debt

Mezzanine Value Propositions For Investors : *Opportunities for Two Major Uses*



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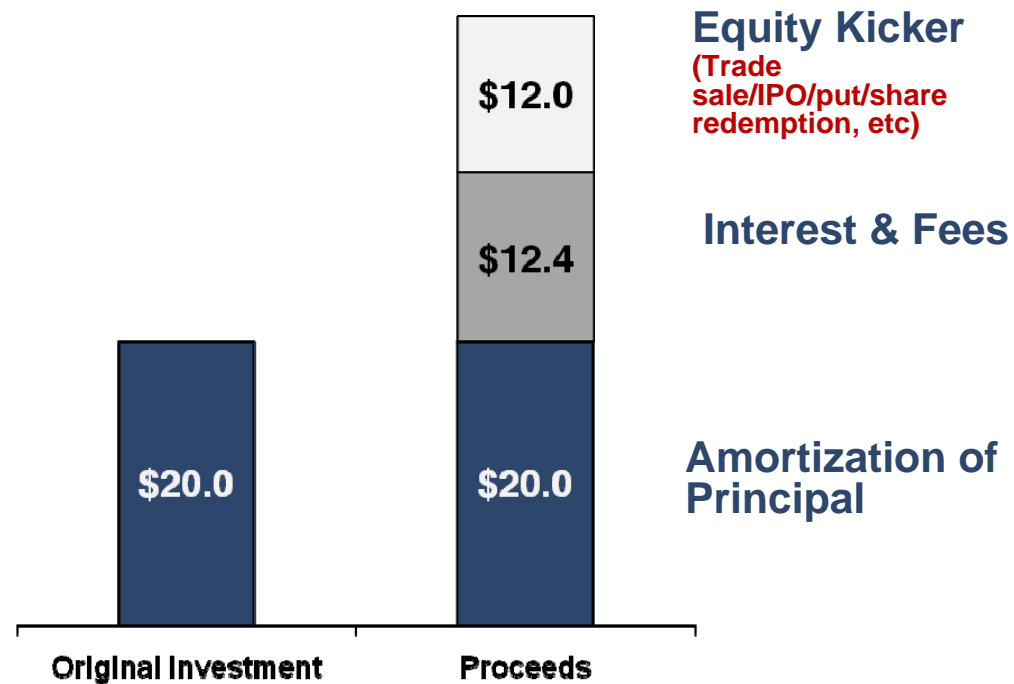


	Buyout	Growth Capital
Investee Companies	Investees usually larger in revenues, and slower-growing	Often smaller in revenues, but much faster-growing
Format	Usually provided as part of a package of senior debt and mezzanine	Usually mezzanine on stand-alone basis Sometimes used in conjunction with equity, with mezzanine serving as a replacement for more dilutive equity
Final Maturity	Mezzanine typically longer-term (e.g., 7-8 years) <ul style="list-style-type: none"> ▪ no amortization prior to pay down of senior debt ▪ Bullet or near-bullet maturity 	Typically shorter-term (e.g., 5 years) than buyout mezzanine
Other Debt	Significant amounts of amortizing secured senior bank debt	Usually much smaller amounts; but sometimes short term (e.g., < 365 days)
Investment Returns	Generally lower, with higher contractual returns, less equity upside	Generally higher, with more equity upside, and lower contractual returns
Borrower Sophistication	Generally quite high	Moderate



Exit from a mezzanine Investment can be primarily via the cash flows of the Company

The return on a \$20 million, 5-year investment, with a coupon of 12% p.a., 2% fee, and a total IRR of 21% would have the following components:



Mezzanine Value Propositions for Investors: *Lower Correlation of Funds to Other Asset Classes*



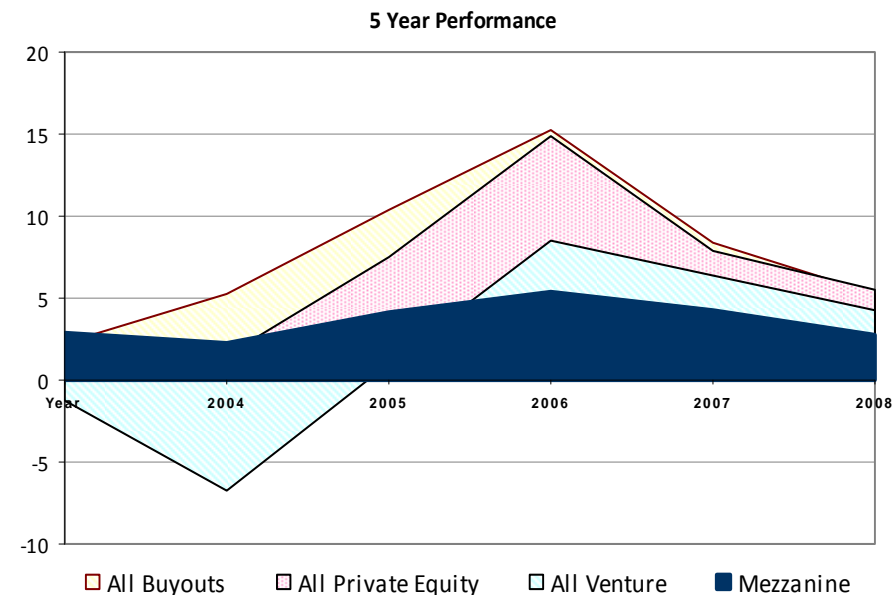
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- Mezzanine fund performances generally do not correlate with traditional asset classes, which enhances portfolio diversification. Mezzanine has also proven to be less susceptible to economic cycles.
- Based on US data, mezzanine funds have a low correlation with both (a) public equity returns, and (b) other private equity asset classes (VC, Buyout PE, Growth PE).
- Although the newness of market in Asia does not allow for definitive historical data analysis, it is reasonable to believe that mezzanine investing in Asia may have a similarly low correlation to each of the following asset classes: (a) global equities, and (b) Asia private equity.
- For investors that have existing private equity investment portfolios, investment in certain types of mezzanine funds is reasonably likely to provide a positive diversification effect.

Thomson Reuters US Private Equity Performance Index (PEPI) (Q4 2009)

Fund Type	3 Years	5 Years	10 Years	20 Years
Early/Seed VC	-1	0.9	-0.3	23
Balanced VC	0.9	6.8	2.3	15
Later Stage VC	5.6	7.6	1.7	15
All Venture	0.9	4.3	1.1	17.7
Small Buyouts	0.1	4.2	3.4	11.5
Medium Buyouts	3.6	8.7	4.1	10.8
Large Buyouts	2.7	6.7	4.9	10.5
Mega Buyouts	-1	4.8	4.7	7.8
All Buyouts	-0.3	5.3	4.6	8.9
Mezzanine	0.7	2.8	2.9	6.8
All Private Equity	0.8	5.5	4	11.2
NASDAQ	-2.7	0.8	-5.6	8.9
S&P 500	-8.1	-1.6	-2.7	6.3

2004-2009 Thomson Reuters PEPI Trend



Mezzanine Methods of Investing: *Some Structural Variations*



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Debt w/ Step-up or PIK Interest	Debt with Warrants	Convertible Loan	Participating Loans	Convertible Preferred Equity
<ul style="list-style-type: none"> ▪ Subordinated Debt with large amount of PIK interest deferred ▪ No equity participation, but potential for high IRR nonetheless ▪ Principal repayment is typically back-ended ▪ Does not work well for longer term finance as PIK balance gets quite large 	<ul style="list-style-type: none"> ▪ Typically debt with detached warrants ▪ Principal is repaid after senior debt is largely or fully repaid ▪ Cash Coupon ▪ Warrants typically have zero or very low strike price ▪ May also have "full" strike price (but inherently more dilutive) 	<ul style="list-style-type: none"> ▪ Typically subordinated ▪ Principal repaid at maturity, unless conversion occurs ▪ Inherently more dilutive than debt w/ warrants ▪ More applicable on eve of IPO, or a PE investor seeking max downside protection 	<ul style="list-style-type: none"> ▪ Alternative form of mezzanine ▪ Base interest rate plus performance-linked spread ▪ Interest rate linked to net profit, EBITDA, or sometimes sales – easy to "game" ▪ No equity ▪ Cumbersome to structure in practice 	<ul style="list-style-type: none"> ▪ Similar to convertible loan, except default on a payment does not accelerate other debt, and cannot force an issuer into bankruptcy ▪ Essentially a form of "senior equity" ▪ Widely used in startup financings – basically it is equity
Subordinated Debt	Direct		Indirect	Senior Equity

Subordinated Debt with Equity Participation

Mezzanine Methods of Investing: *Key Pricing Considerations*



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- Structure – how debt-like vs. how equity like
- Industry of investee
- Size of company
- Competitive position
- Overall investee credit metrics
- Leverage in transaction -- operational vs. financial
- Overall market conditions

- Multiple components of mezzanine return
 - > Upfront fee
 - > Cash interest
 - > Non-cash interest
 - > Equity upside
 - > Put rights
 - > Prepayment penalties
 - > Other